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A REVIEW OF BUSINESS CONDITIONS

Confidential



Agricultural-Industrial Relations Section

A.A.A.

A REVIEW OF BUSINESS CONDITIONSRetrospect and Prospect

As the business review was being prepared a year ago, industrial production was slumping badly and the outlook was for a materially lower average level for 1938 than had prevailed in the year then ending. As a matter of interest, the prediction was made at that time that industrial production for 1938 would average 10 to 15 percent lower than in 1937 and that on a monthly basis production would not exceed that for a corresponding month of the year then ending before October. Actually, the average decline in production for 1938 amounted to about 21 percent and for each month until November the level was lower than for the corresponding month of 1937.

As the year 1938 ends the situation is just the reverse of that a year earlier. For six months industrial production has been on a steep climb. During this time the distance traversed, according to the Federal Reserve Board index, amounts to about 35 percent. This is the sharpest recovery for any similar length of time of which we have a record excepting the pre-N. R. A. recovery of 1933. Weekly indexes of production and of business activity since the last week of November are suggestive of a current flattening out to the recovery movement. As yet there is no evidence that this halt is apt to be followed by anything more than a temporary relapse minor in proportion to the advance of the past six months. It is probably in the nature of a breathing spell after the record sprint since last June.

We expect an average recovery in industrial production for 1939 as compared with that of the year just ending of 20 to 30 percent. If this estimate of the amount of change should prove as conservative as that made a year earlier then 1939 would indeed be a year of dynamic recovery. In this connection it might be of interest to observe that were the Federal Reserve Board index of production for 1939 to adhere to the course followed through a typical recovery (as pictured on an accompanying chart) it would average 112 in 1939. The 1938 average, according to the typical pattern, should have been about 84 whereas it actually amounted to 86 (December estimated). Adherence through 1939 to the typical pattern would result in a new high monthly record on the Federal Reserve Board index before the end of the year and the annual gain would be as great as the upper limit of our estimate previously mentioned. A survey of apparent prospects in steel and automobiles, which industries account for a large portion of the moves in the Federal Reserve Board index, does not seem to justify the expectation of an increase of this magnitude.

A year-to-year 1938-to-1939 gain of around 20 percent in the Federal Reserve Board index is about as much as we have been able to rationalize by means of estimates of movements in the various important

industries. Nonetheless, it might be mentioned that the actual production index toward the end of 1938 was well above that of the typical pattern. It also may be noted that our quarterly estimate of 97 for the Federal Reserve Board index in the final quarter of 1938, shown in the October Review of Business Conditions, was apparently about 4 points low. Should the trend through the first three quarters of 1939 follow the pattern outlined by our October estimates, after adjustment for the higher level already attained, the Federal Reserve Board index would average close to 110 in the September quarter of 1939.

Any relapse in productive activity at this time (suggested as probable in the October review and also by recent weekly indexes) will probably be only sufficient, at worst, to halt for a time the strong advance in national income which has again appeared. The expected 1939 increases in industrial production and in national income should result in better demand for farm products both for use as industrial raw materials and as food.

National Income

In part, no doubt, due to the short period of time consumed in the drastic 1937-38 decline in productive activity, nonagricultural income was but moderately reduced. Such income in 1938 is estimated at 60 billion dollars--a decline of just 4 billion dollars or a little over 6 percent. The extreme decline in nonagricultural income from August 1937 to June 1938 amounted to about 11 percent or less than one-third as great as the extreme decline of 35 percent in industrial production.

In agriculture the decline in cash income from sales (after correction for seasonal variation) amounted to 33 percent from the July 1937 peak to February 1938. Recovery from the February low has been irregular but for the 9 months from March to November inclusive farm cash income from sales averaged 14 percent higher than in February.

Farm Cash and National Income (Million dollars)

	National income	Farm cash income			Ratio farm to national:	
		From sales	From benefits	Total	From sales (Pct.)	Total (Pct.)
1929	79,704	10,479	---	10,479	13.1	13.1
1932	48,644	4,328	---	4,328	8.9	8.9
1937	71,013	8,233	367	8,600	11.6	12.1
1938	66,100	7,125	500	7,625	10.8	11.5
1938 by quarters, (adjusted for seasonal variation:						
1st	16,480	1,691	108	1,799	10.3	10.9
2nd	16,174	1,786	149	1,935	11.0	12.0
3rd	16,425	1,932	77	2,009	11.8	12.2
4th 1/	17,021	1,716	166	1,882	10.1	11.1

1/ Advance forecast for December.

National income, including agriculture's contribution, is estimated at 66 billion dollars in 1938 as compared with 71 billion dollars in 1937. On the basis of expected 1939 trends in production and prices we now estimate that national income will recover to the 71 billion dollar figure of 1937. A 1940 gain in productive activity over the anticipated average level for 1939, as suggested by the typical trend, would probably result in a 1940 national income approximately equivalent to the previous peak reached in 1929. This would, of course, still be considerably lower on a per capita basis than in 1929, owing to an increase of about 9 percent in population, and would not create sufficient additional demand for full employment of available workers.

Though the percent of national income used for the purchase of food tends to decline moderately with rising income the actual dollar expenditures rise with increased income. With higher retail food sales the farmer may be expected to get a larger gross income, from food products, and in the absence of unusual price movements, a larger portion of the consumers' food dollar.

Nonagricultural Employment Prospects

Several studies have recently been made in this section concerning trends in the agricultural working force of the country and in employment and unemployment among the nonagricultural workers. Since there is a fairly close relationship between industrial production and nonagricultural employment the data developed in these studies may be used in estimating the level of productive activity necessary to full employment of the nonagricultural working force. Production for 1937-38 (1938 given twice the weight of 1937) would apparently have needed to average 137 to have given employment to 95 percent of the nonagricultural gainful workers this year. About 5 percent of the workers have ordinarily been unemployed in periods of business prosperity. Actually for 1938 the two-year weighted index of industrial production was 94. As a result of this wide difference in actual and needed production nonagricultural unemployment is estimated to have averaged 9,600,000 in 1938. This estimate makes no allowance for the abnormal 1930 to 1937 increase of about $1\frac{1}{2}$ million in the working force as shown by the Bigger's Census of November 1937. Including these, average 1938 unemployment among nonagricultural workers was approximately 11,000,000.

Looking ahead for the next two years, it is estimated that a weighted production index of 140 in 1939 and of 143 in 1940 would be necessary if 95 percent of the nonagricultural workers were to be employed. The prospective weighted average indexes for 1939 and 1940 (still using the typical pattern) would be approximately 103 and 120 respectively. This would be sufficiently short of requirements for full employment to leave an average of over 8 million nonagricultural

workers without jobs, at regular occupations, in 1939 and about 6 million in 1940. There would in 1940 be about 4 times as many unemployed as the average for 1929 when the weighted index of production was 116. The 1929 to 1940 increase in the nonagricultural working force of 5 million is largely responsible for this greater prospective unemployment despite the higher assumed level of productive activity. These estimates make no allowance for an excessive increase in workers between 1930 and 1937 as found by Bigger's.

It is apparent that national farm programs must necessarily take into account the effect on purchases of food and clothing of this prospect of serious unemployment among the nonagricultural population for a prolonged period.

Construction

That there is considerable inherent strength in the present recovery movement in construction is rather evident from the fact that contracts awarded in 1938 (the last half of December estimated) totaled about \$3,130,000,000 according to F. W. Dodge, as compared with \$2,913,000,000 in the previous year. This is quite a favorable showing, to put it mildly, for a year in which industrial production, as measured by the Federal Reserve Board index, fell from 110 to 86 on an annual basis.

If any more proof of inherent strength in the building situation is needed, the strong upward surge in the last half of 1938 may be cited. The evidence is all the more convincing because the improvement was common to residential, nonresidential, public utilities, and public works; sufficiently so in each instance except in nonresidential building to bring the annual dollar value of contracts awarded above the total of the previous year despite a poor start in the early months of 1938.

The following tabulation shows the dollar value of contracts awarded as reported by the F. W. Dodge Corporation for 1938 and several preceding years and gives also our estimates for 1939.

Construction Contracts Awarded (Million dollars)

	<u>1928</u> (Peak)	<u>1933</u> (Low)	<u>1937</u>	<u>1938</u>	<u>1939</u> (Est.)
Residential	2,788	249	905	980	1,400
Nonresidential	2,375	404	1,156	1,050	1,300
Public utilities <u>1/</u>	484	103	263	280	350
Public works	980	500	589	820	850 <u>2/</u>
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	6,628	1,256	2,913	3,130	3,900

- 1/ The peak in public utilities was 701 million dollars in 1930.
- 2/ Allotments under the Public Works Administration construction funds appropriated early in 1938 required that work was to be begun by the year end. This, of course, tended to increase contracts awarded in 1938 but as only a beginning was required additional contracts on these projects may equal or even exceed those already let.

Should the value of contracts in 1939 increase as much as our estimates suggest--namely about 25 percent--the increased purchases of building materials and the increased wage payments to building labor would be a major influence toward continued improvement in economic conditions.

The more important role of construction in the present phase of recovery than in that which culminated in 1937 is evident from our expectations of a billion dollars more in contract awards for 1939 than the total two years earlier, whereas industrial production is not expected to be as high. On the basis of usual cyclical movements, building activity should continue to contribute materially toward rising productive activity for at least two more years. Though recovery cycles in construction do not by any means follow a uniform pattern the present situation (after 4 years of recovery) suggests that we may be entering a period of more rapid gains in construction activity.

Automobiles

After having remained at a severely depressed level during the first 9 months of 1938 automobile production speeded up with introduction of new models. Production of passenger cars and trucks in the United States reached one million units in the final quarter of the year bringing the annual output to slightly over 2,500,000 as compared with 4,809,000 in 1937.

All reports indicate that dealer sales to users have continued to be exceptionally brisk with the result that floor stocks are still low. This failure of dealers as yet to stock as many cars as usual makes certain a continued high rate of automobile production early in 1939. The high rate of absorption of the new cars by the buying public since introduction of 1939 models, together with a continued strong upward trend in national income suggests that this buying movement may continue right through the new year. To anticipate an output of close to 4 million cars in 1939 with production for the first three quarters of the year approximately double that of the corresponding period of the year just ending does not appear unreasonable.

Although the direct effect of such a large gain as we are expecting for automobiles in 1939 would be to increase the Federal

Reserve Board's industrial production index by only about 3 points, the stimulation to other industries of a 50 to 60 percent recovery in automobiles would probably be even greater. Improvement incident to higher automobile output extends down through steel and iron, accessory plants, tire factories, glass, chemicals and various other miscellaneous lines. Obviously, the direct influence is greatly magnified through this stimulation to other groups.

Steel

The automobile industry leads in the consumption of steel followed closely by building and metal containers. The outlook for automobiles and building, as discussed above, is particularly favorable to steel in 1939. The metal container industry was sorely depressed in 1938 with the result that important price concessions were recently announced on tin plate. With general economic conditions improving it is but reasonable to expect a good gain in the use of steel for metal containers during the coming year.

Similarly, railroads which are in normal times heavy users of steel have been practically out of the market during the past year. Very recently, some important rail contracts have been let and an increased interest is noted in inquiries concerning rolling stock. Except for the fact that the Federal Government seems to be taking an increased interest in the rail situation there would be no reason to expect substantial steel business from the railroads in 1939; not because they are not in need of new equipment and track steel but because they are not in a position to finance extensive purchases.

Outside of these four important users of steel and perhaps armaments and shipbuilding, gains in consumption may be expected to be governed largely by the trend of general economic activity. On the basis of relative trends in steel and industrial production from 1919-1938 we estimate ingot output in 1939 between 40 and 45 million tons as compared with 28 million in 1938 and 50 million in 1937. The 1939 estimate assumes a Federal Reserve Board index of 105 as compared with 86 in 1938.

Prices and Living Costs

Although daily quotations show some strengthening in commodity prices late in December, weekly all commodity indexes of the Bureau of Labor Statistics reached successive lows, for the present decline, in each of the weeks ending December 10th, 17th and 24th. That this weakness was not due entirely to the trend in farm and food products prices is indicated by the fact that the index for all commodities other than farm and food reached a new low for the current period in the week of November 12th and in the six additional weeks for which price indexes

are available, since this low was reached, further declines totaling one-half percent have occurred bringing the index down to 80.5 percent of the 1923-25 average. Though food prices have declined rather substantially in the past month farm products prices in wholesale markets have held about flat and prices received by farmers were moderately higher in December than they were a month earlier.

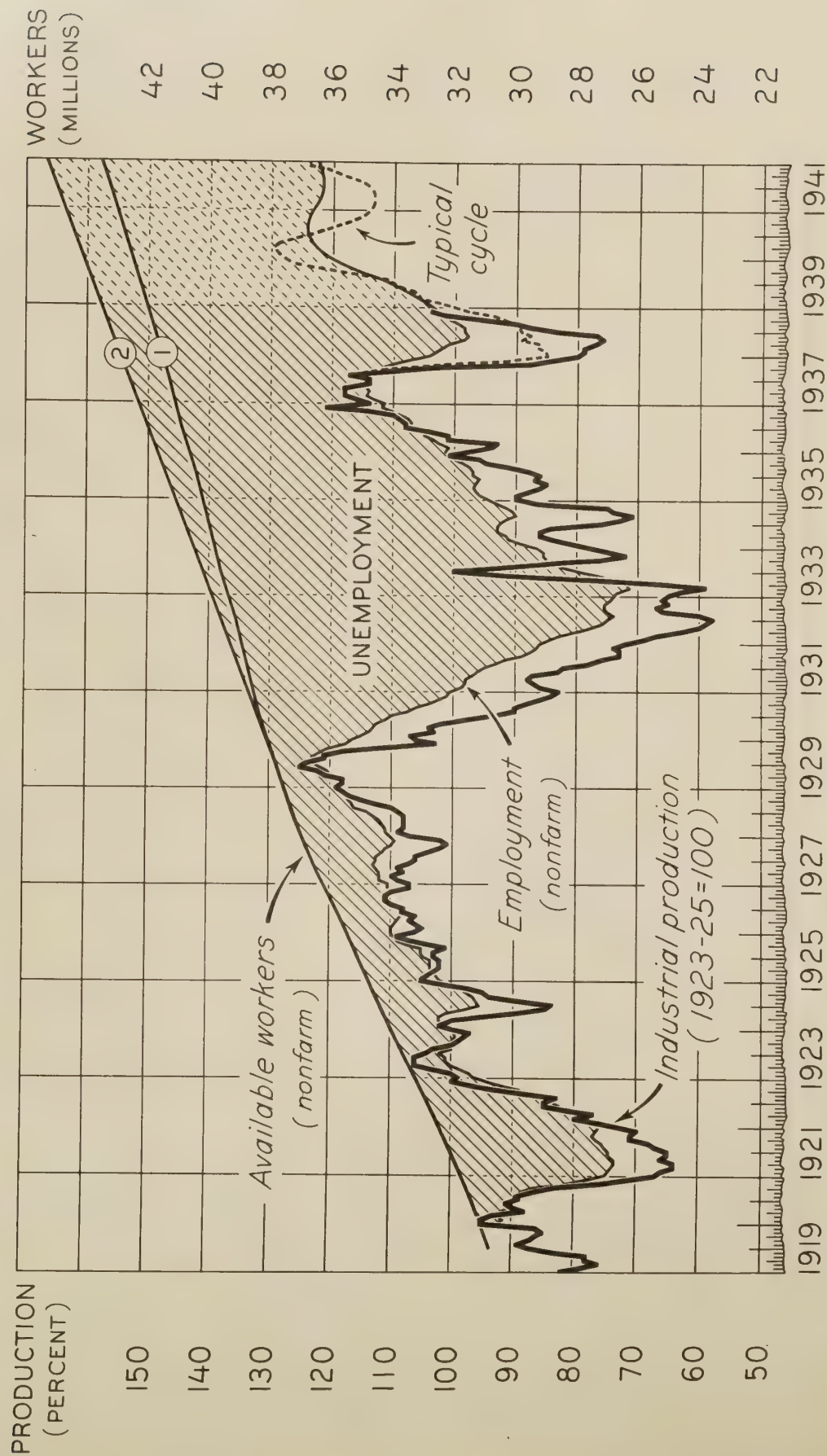
Prices of raw materials in the week of December 24th were 23 percent lower than at the April 1937 peak. The decline in semi-finished goods for the same period amounted to 17 percent. Finished goods prices continued to increase for about five months after raw materials and semi-finished goods had reached their peak and since September 1937 have declined only 10 percent. Raw materials, farm product and semi-manufactured goods prices have followed a generally sidewise course since last May but finished goods, which usually reflect recovery influences late, have continued to drift slowly downward.

Although there apparently have been moderate additions to inventories in some lines of goods during the last quarter of 1938 the failure of commodity prices to develop any strong upward movement, at any time during the current recovery in production, has tended to discourage heavy forward buying. Under these conditions further weakness in prices, so long as it remains moderate, will not have the same adverse effect on business sentiment as would have been true had business policies mistakenly anticipated a strong advance. Nonetheless, weakness in commodity prices, though it be moderate, at a time when productive activity is leveling off perhaps preparatory to some relapse, injects an added element of caution into the business picture. Any renewed weakness in commodity prices might conceivably emphasize somewhat the temporary relapse which we are expecting; acute weakness, sufficient to be a threat to the entire recovery movement, is not expected.

In a similar manner to finished goods prices, living costs have continued to drift lower. In November the cost of living index is estimated to have been 82.5 percent of the 1923-25 average as compared with the October 1937 peak of 85.2 percent--an extreme decline of nearly 7 percent. Ninety percent of the entire decline is due to lower retail food prices.

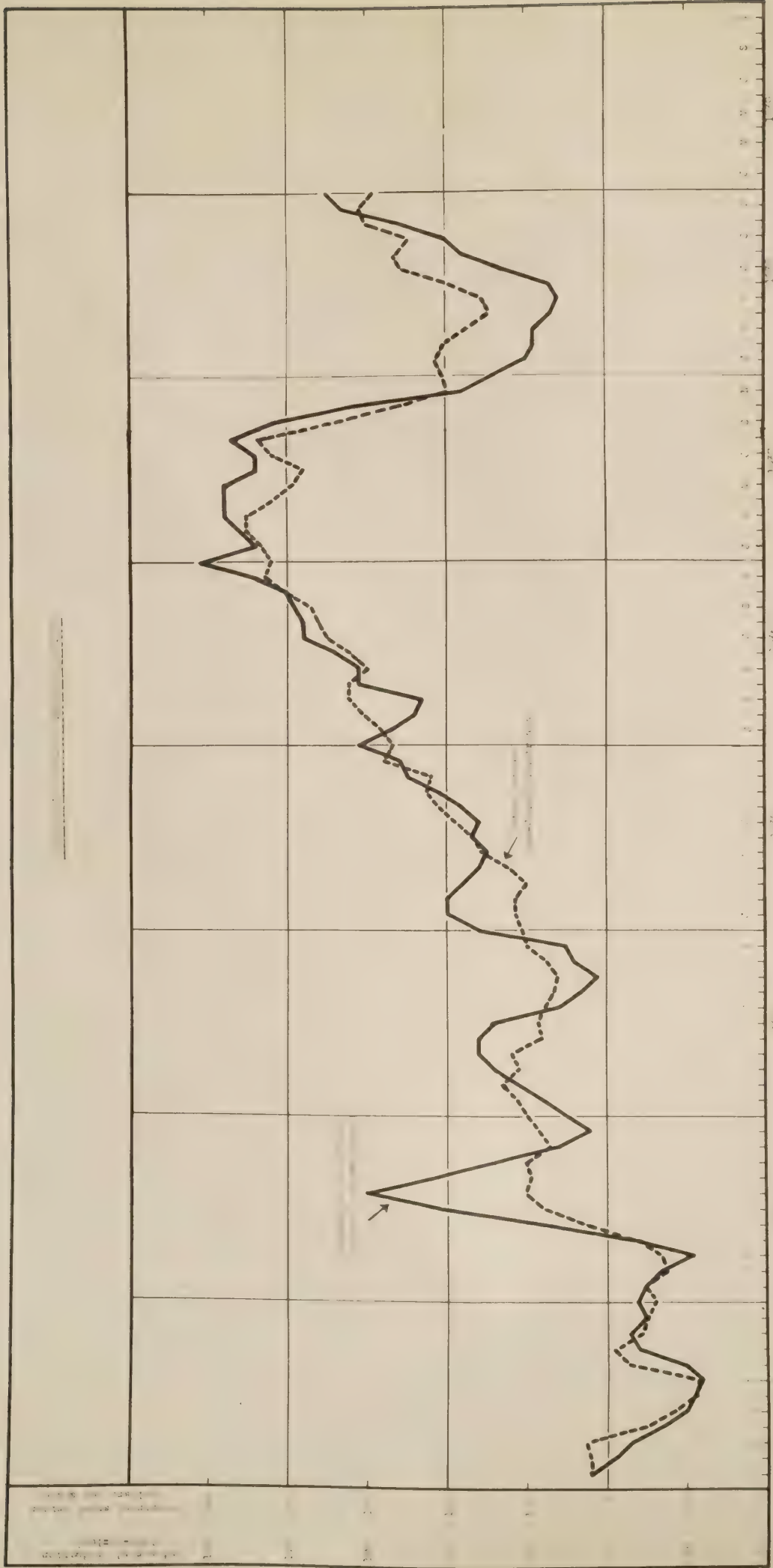
Up to this time none of the recovery in consumer income from mid-1938 has been required to meet living budgets. In fact, a slight decline in living costs during the last half of 1938 contributed toward a restoration in urban buying power at a somewhat faster rate than the increase in dollar income. If national income recovers in 1939 to the 1937 level, as is now expected, food purchases at retail should increase by more than half a billion dollars. A substantial portion of this increase should get back to the farmer.

INDUSTRIAL PRODUCTION AND INDUSTRIAL EMPLOYMENT AND UNEMPLOYMENT, U.S. 1919 TO DATE

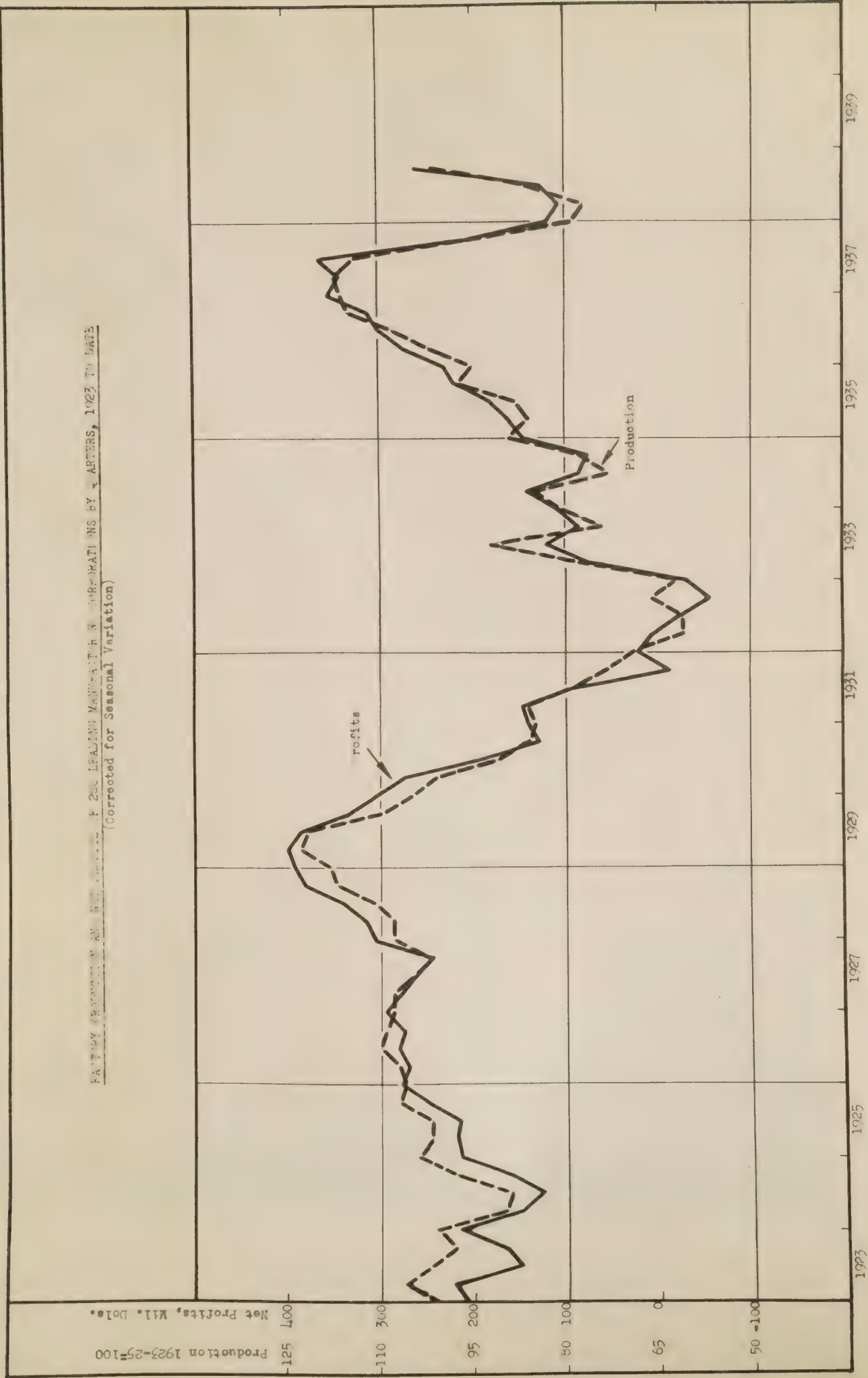


① ESTIMATE BASED ON CENSUS DATA

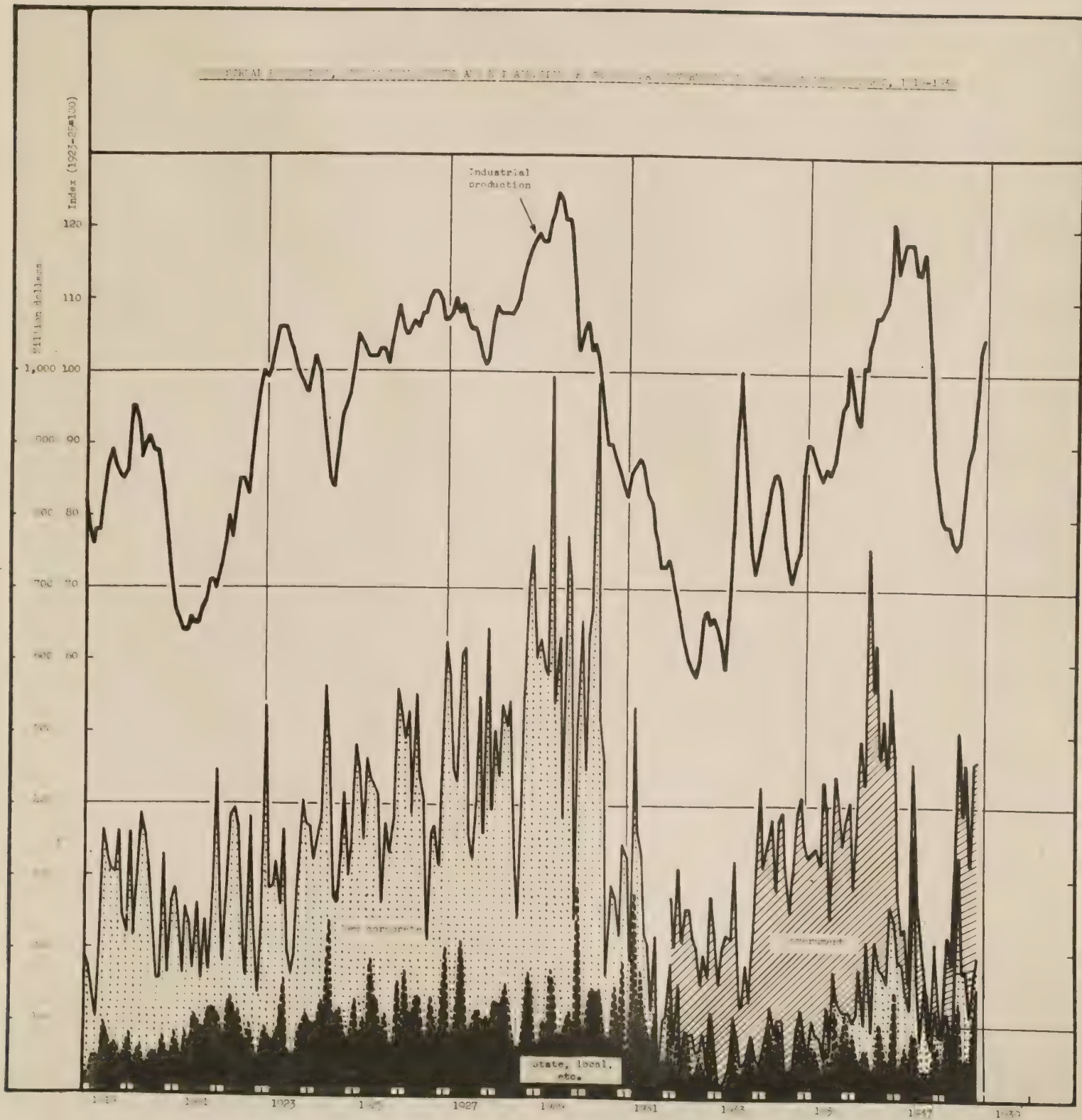
② ESTIMATE ADJUSTED FOR FINDINGS OF 1937 UNEMPLOYMENT SURVEY



PATTERSON AND COMPANY, INC. LEADING VARIOUS CORPORATION BY ARTS, 1923 TO DATE
 (Corrected for Seasonal Variation)

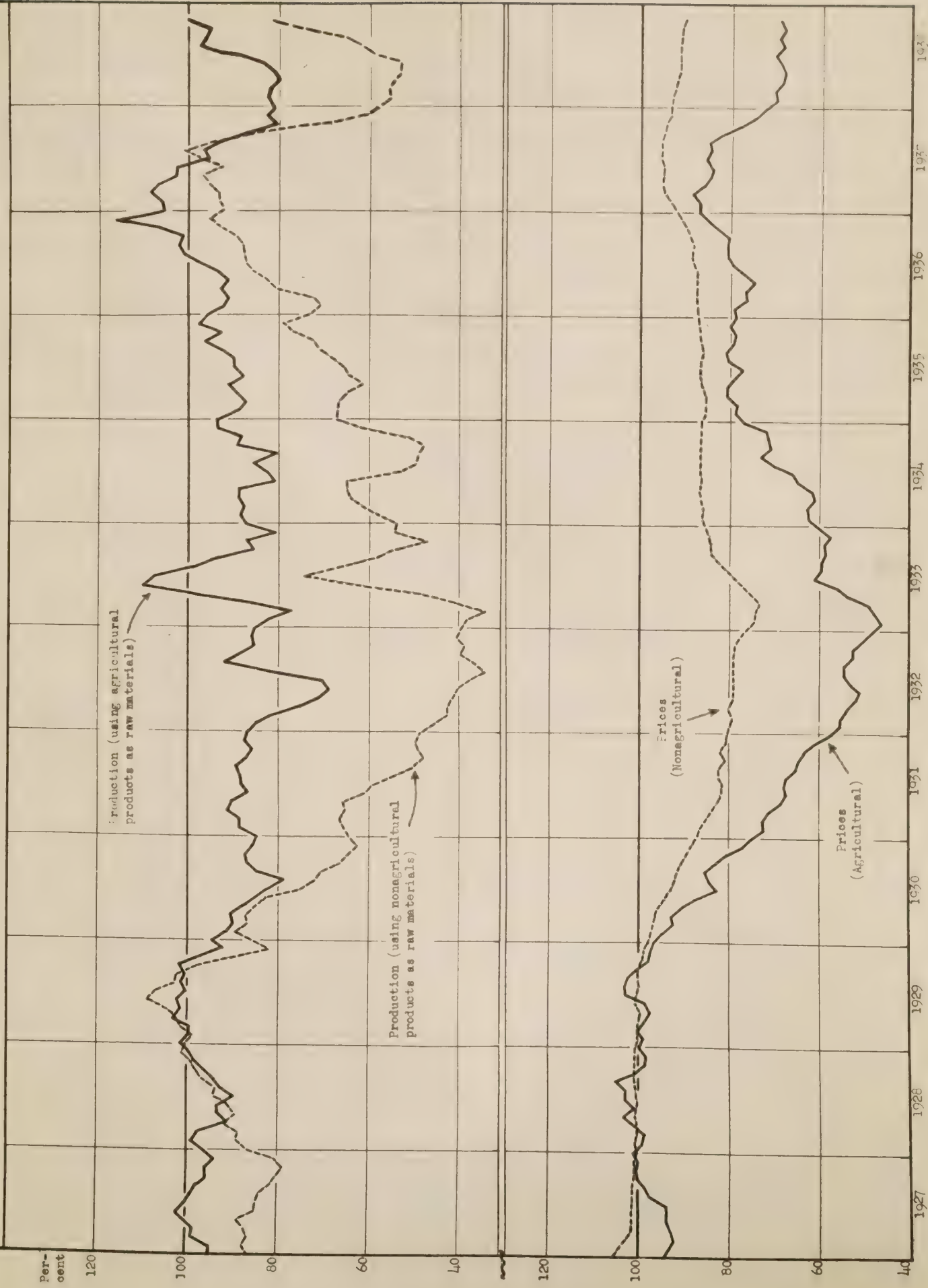


SERIAL 1, 1920-1939, TO A DIAPHRAGM FROM A COPY OF THE 1939, 11-14



MANUFACTURING OUTPUT AND WHOLESALE PRICES

1927=100

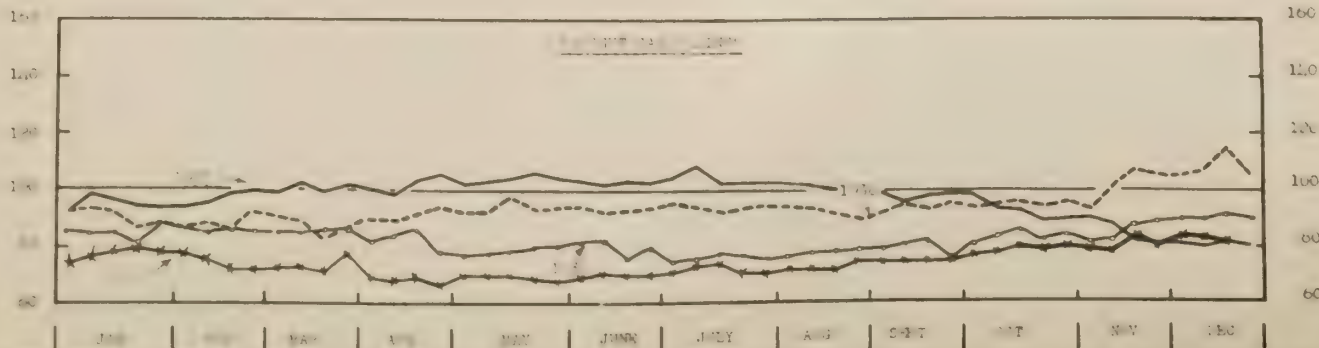
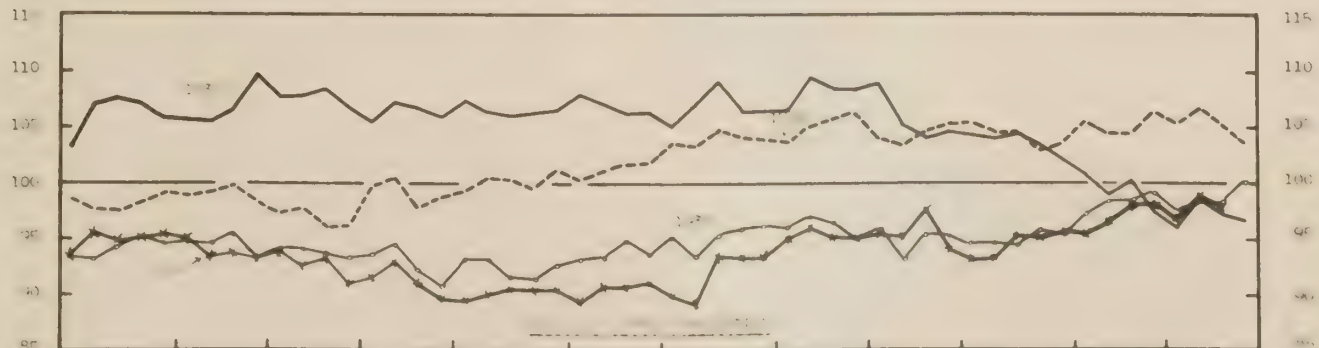
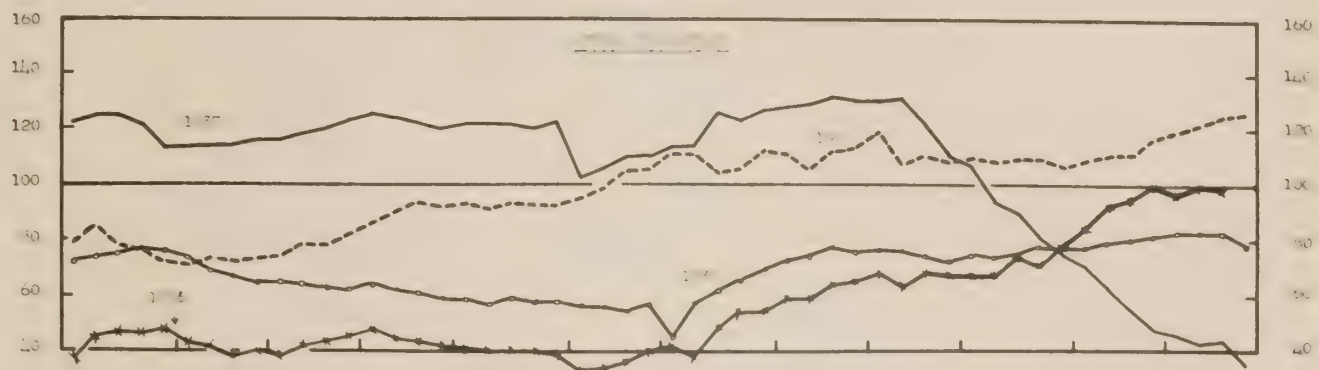
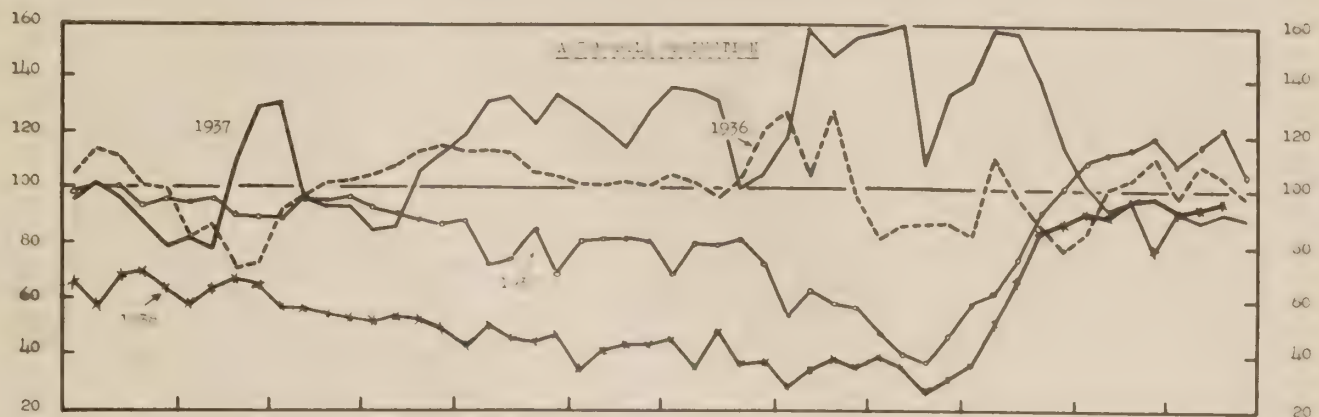
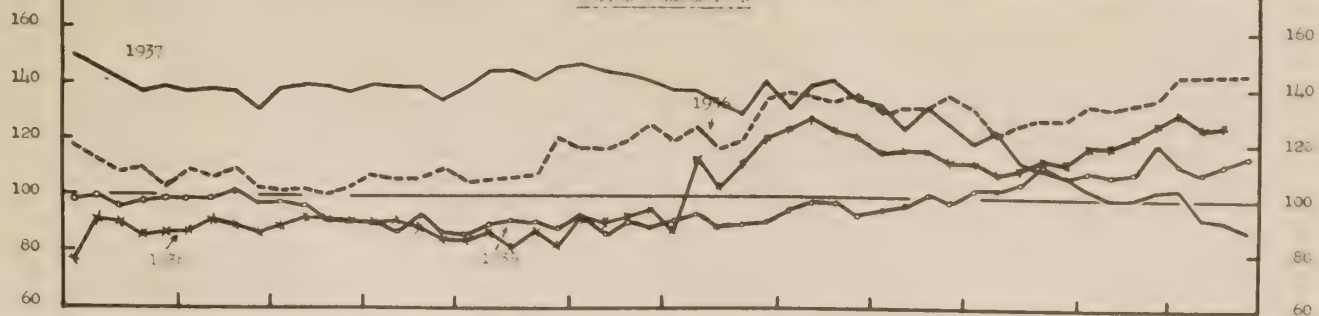


WEEKLY BUSINESS INDICATORS

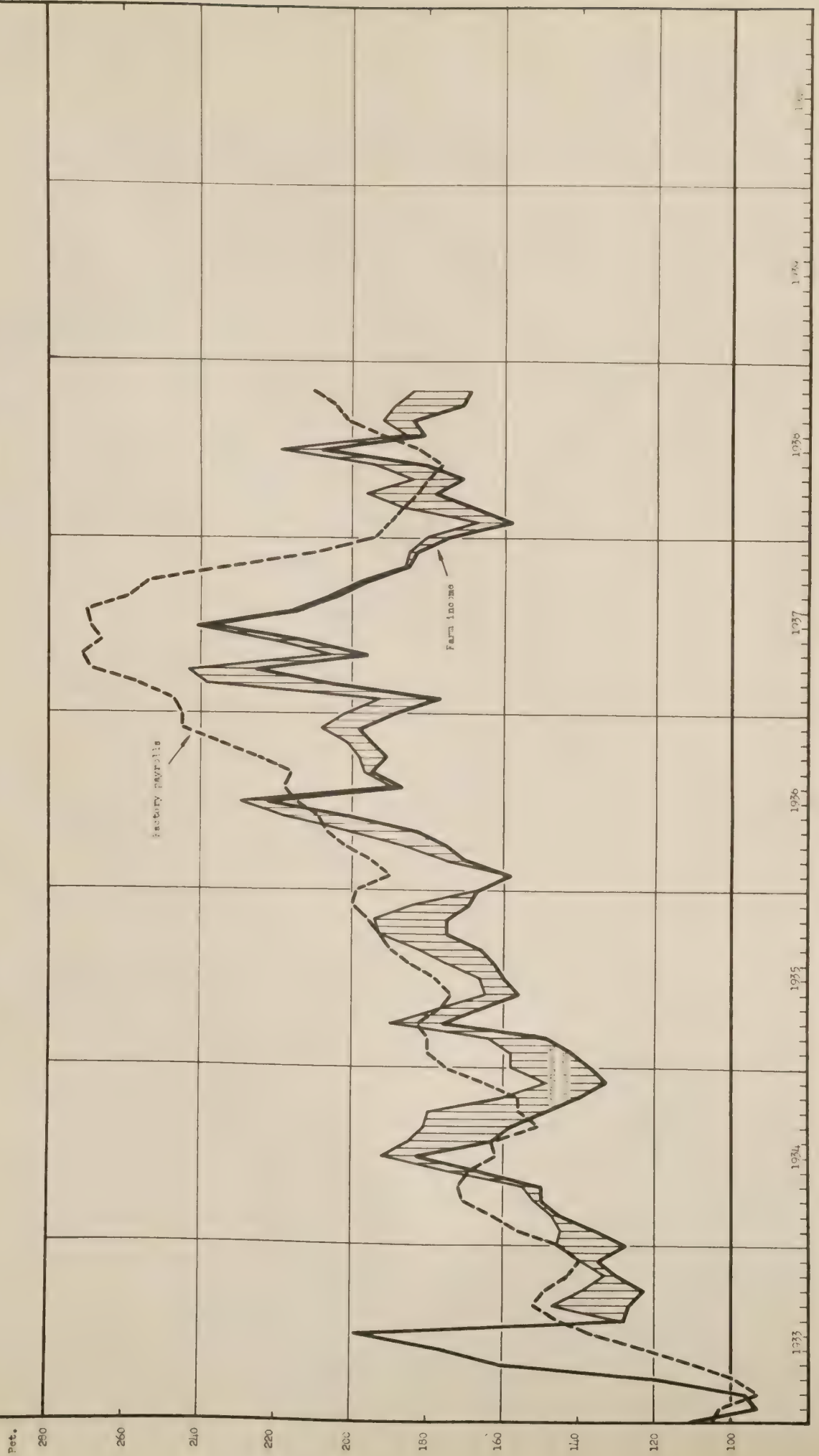
Adjusted for Seasonal Variation
Estimated Normal = 100

Percent

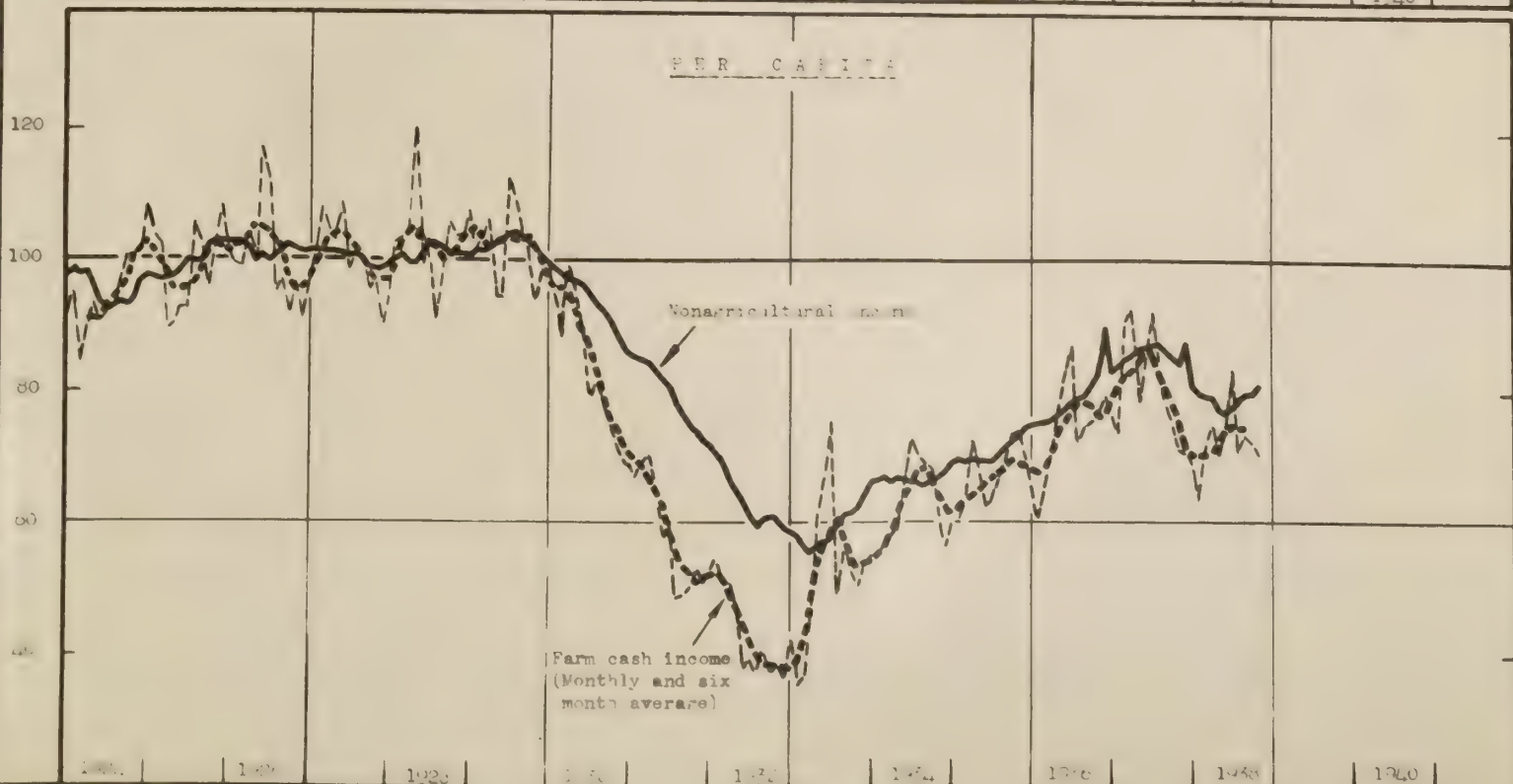
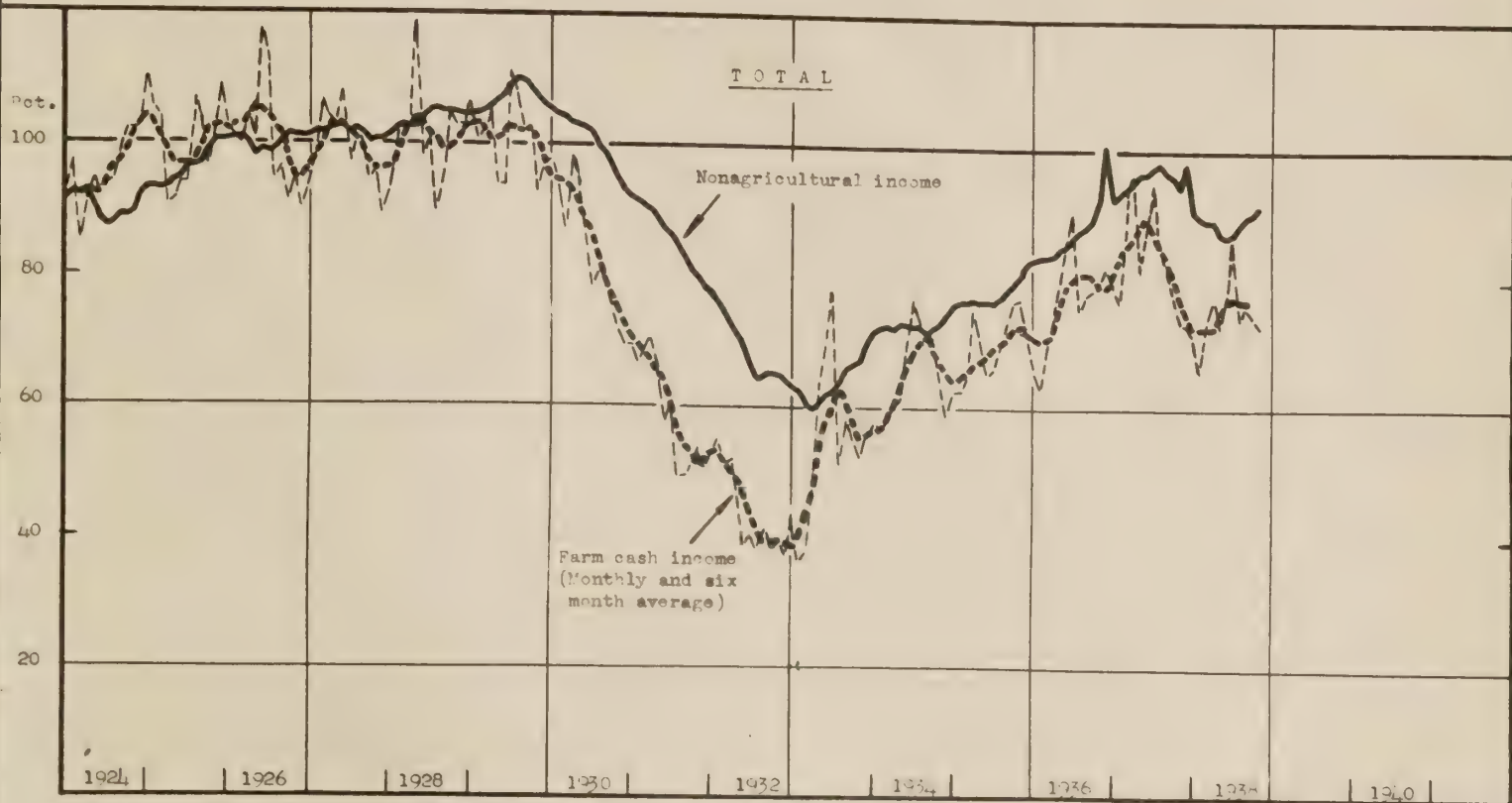
Percent



BASE FARM INCOME AND FACTORY PAYROLLS, JANUARY 1933 TO DATE
(Seasonally corrected indexes, First quarter 1933=100)



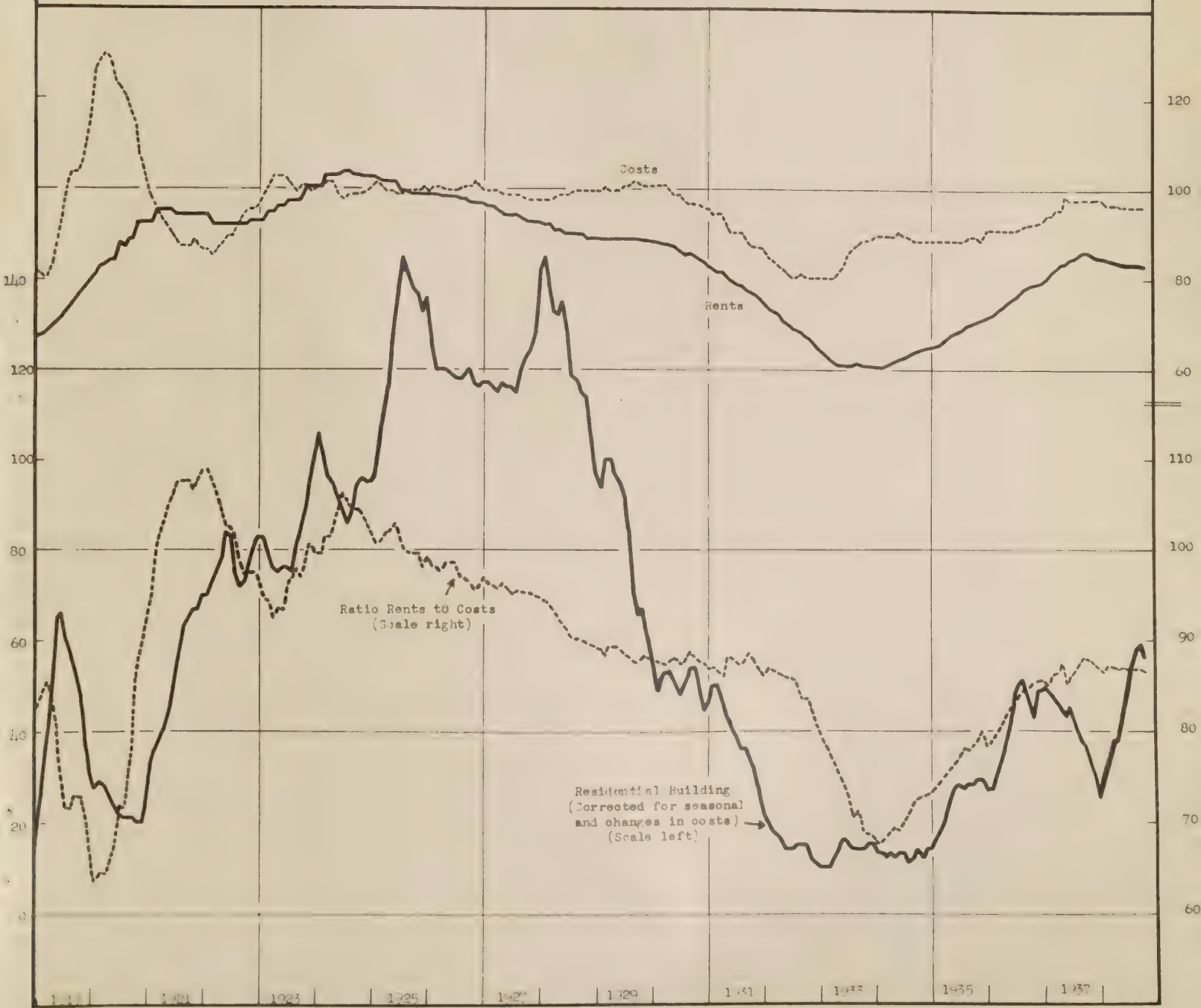
INDEXES OF NONAGRICULTURAL AND FARM CASH INCOME, TOTAL AND PER CAPITA
Seasonally corrected indexes, 1924-29=100



RESIDENTIAL BUILDING

(Indexes of Volume, Costs and Rents)

1923-5=100



WEEKLY WHOLESALE COMMODITY PRICES

1926 = 100



INDEXES OF COST OF LIVING, 1919 TO DATE
1921-29-100

